the absence of any such legal entitlement, it nevertheless has sufficient authority to provide utilities a "reasonable opportunity" n25 to collect their stranded costs during a transition period from regulation to competition in the electric generation sector. n26 The Department finds that it has authority under G.L. c. 164, @@ 76 and 94 to implement such a policy and that such a policy, if properly designed and implemented, would be in the public interest.

The generation and sale of electricity by electric utilities is governed by G.L. c. 164. This comprehensive statute promotes the fundamental state policy of ensuring uniform and efficient utility services to the public. See, e.g., Boston Gas Company v. Somerville, 420 Mass. 702, at 704, 706 (1995). Pursuant to G.L. c. 164, @ 76, the Department has broad general supervisory power over the provision of electric service in Massachusetts and electric utility compliance with all pertinent statutes and Department regulations. See Incentive Regulation, D.P.U. 94-158, at 41. The Department also has broad authority to regulate rates in the electric industry under G.L. c. 164, @ 94. See, e.g., American Hoechest Corporation v. Department of Public Utilities, 379 Mass. 408 (1980); Boston Real Estate Board v. Department of Public Utilities, 334 Mass. at 484-485; D.P.U. 94-158, at 43. These statutes and the cases interpreting them establish sufficient Department authority to grant stranded cost recovery during a transition from regulation to full competition in the electric generation sector, provided granting such recovery is in the public interest.

d. Department Policy on Stranded Cost Recovery

[30-33] The transition to competition in electric generation will appropriately reallocate some risks and opportunities for benefits and thereby change the relationships between participants in today's industry structure. The current industry structure has clearly produced some benefits for ratepayers, including a high level of safety and reliability in the operation of the electric utility industry. A smooth, orderly, and expeditious transition from regulation to competition would carry these strengths forward into a restructured electric industry and would be in the public interest.

In order to achieve such a transition to a fully competitive generation market, it is essential to address the stranded cost issue. In some cases, costs that may be stranded today were reasonably incurred to ensure the high level of electric services to which ratepayers in Massachusetts have become accustomed. A structured transition that allows an appropriate measure of stranded cost recovery, rather than risking the abrogation of existing commitments, would be in the public interest, because it would ensure the provision of sound electric services during the transition. Existing commitments also should be honored because the reliability of commitments in general is an essential element in any future industry structure.

In addition, the Department sees potential gain to the public from allowing stranded cost recovery as a means of promoting federal and state coordination and ensuring equal treatment of similarly-situated utilities. First, coordination would discourage forum-shopping and efforts to restructure in order to avoid state jurisdiction. Forum shopping could occur if one regulatory authority offered more favorable stranded cost recovery provisions than another. n27 Coordination would also reduce the attractiveness of pursuing litigation on the issue of jurisdiction. Second, some states have expressed concern that it would not be beneficial to their citizens to open themselves to competition from out-of-state utilities, while the markets in neighboring states remained closed.

There may be greater benefits to Massachusetts consumers from competition if neighboring states also open their electric generation markets to competition and customer choice, because of the benefits that may be derived from expanded economic electricity exchanges.

Finally, the Department is concerned that a move to full competition without making a provision for some measure of stranded cost recovery could provoke costly, reform-delaying litigation. These factors could in turn reduce the quality of electric service and delay the arrival of benefits from competition. Delay and litigation uncertainty are clearly not in the public interest and policy reform should seek to avoid these results. Accordingly, the Department recognizes the need to afford electric utilities a reasonable opportunity to recover stranded costs during a transition period.

Although the Department's stated policy provides for transitional stranded cost recovery, the Department cannot here decide the outcome of the many individual adjudications of stranded cost claims that could become necessary if utilities and other market participants are unable to reach a consensus on electric industry restructuring that is acceptable to the Department. As the Department's legal analysis indicates, the outcome of such adjudications is uncertain. The Department intends this policy pronouncement as guidance to parties in negotiations on this issue.

e. Practical Considerations in Structuring Stranded Cost Recovery

There are several issues related to the design of a stranded cost recovery mechanism for incumbent electric utilities. First, the Department will require the mitigation of stranded costs by all available and reasonable means. n28 Restructuring proposals that include stranded cost recovery mechanisms should include strong incentives for utilities to mitigate stranded costs.

Second, the recovery of stranded costs, unless the recovery mechanism is properly designed, could have anticompetitive effects on the generation market. Open-ended recovery could give a utility an opportunity to price its generation as low as necessary to sell the desired amount of power in the market, while collecting the difference between actual revenue and its revenue requirement through a stranded cost charge. A stranded cost charge also could stifle competition by tying the provision of one service to another. A stranded cost charge may also be anticompetitive if it is designed in such a way that it makes access to the competitive generation market artificially unattractive to customers of incumbent electric utilities. Impeding market access during the period of stranded cost recovery would abrogate the important Department principle of customer choice. Accordingly, any stranded cost recovery mechanism presented to the Department for review should be designed to avoid or minimize any anticompetitive effects.

Third, the Department is concerned that certain mechanisms for recovery of stranded costs may unduly delay significant reductions in electric rates and/or the development of a fully competitive market. The Department believes that the achievement of these goals should be accelerated, not delayed, and that any stranded cost recovery plan should clearly support these goals. Therefore, stranded costs should not be included in an access charge or other recovery mechanism for a period greater than ten years. The Department believes that the bulk of stranded cost recovery can be completed within five years.

Fourth, the stranded cost recovery mechanism should be consistent with the Department's precedent with regard to the non-discriminatory design of utility rates. The Department recognizes that pressure from industrial customers and others for rate relief will likely continue. Stranded cost recovery mechanisms should not be bypassable by any customers nor should they be discriminatory in any way. In addition, stranded cost recovery mechanisms should not assign to other customers the stranded costs that are appropriately allocated to a customer with options.

Fifth, there may be an advantage to establishing a stranded cost recovery mechanism with many of the same characteristics as a financial security. The right to receive stranded cost payments could be transferable to future owners of a particular generation facility with which stranded costs are associated. Transfer rights would facilitate the refinancing and restructuring of the electric utility industry, including efficient, pro-competitive mergers, spin-offs, and other corporate reorganization. Stranded cost revenues could in this way promote the acceleration of industry restructuring, the elimination of high-cost assets from the system, and the efficient employment of the remaining, cost-effective assets.

Finally, proponents of stranded cost recovery should explain how their chosen stranded cost recovery mechanisms would facilitate electric industry restructuring that is in the public interest.

.. Unbundle rates.

a. Introduction

[34-37] As noted in Section III, above, for customer choice to spur competition in a market, customers must be able to compare the prices and terms of the various products and services that are available, and services must be available on comparable terms to suppliers. This requires the identification of distinct products and services and the availability of clear and transparent prices. Thus, electric companies must separate the services and unbundle the rates for the services that they provide. The separation of services is addressed above as a principle for the restructured electric industry. This discussion addresses the unbundling of rates as a necessary step during the transition to increased competition.

The Department believes that the functional unbundling of rates, with appropriate safeguards against cost-shifting and cross-subsidization, is a necessary first step to a competitive electricity market. In restructuring the Massachusetts electric industry, the Department will require that utilities unbundle their rates among the functions of generation, transmission, and distribution. Additionally, utilities are required to unbundle services, including ancillary services, to the greatest extent practical.

The unbundling of rates could result in cost shifting among or within classes of customers, and may implicate cost continuity concerns. Therefore, the Department will require that illustrative unbundled rates, employing new cost of service studies, be submitted by each utility as part of its restructuring proposal. Appropriate transition and revisitation mechanisms, where appropriate, may be a part of such proposals. In this section, we present an analysis of the Department's authority to order the functional unbundling of rates.

b. Department's Authority to Order the Unbundling of Rates

Statutes governing the Department's authority over rates and related case law grant the Department wide discretion over the setting and design of rates. In the gas industry, for example, the Department has ordered the functional unbundling of rates for gas companies subject to its G.L. c. 164 jurisdiction. Chapter 164 also vests authority in the Department to order the functional unbundling of electric rates. i. Statutory Authority

The Department has been granted broad ratemaking authority over gas and electric companies by the legislature. General Laws c. 164, @@ 94 and 94G describe the Department's statutory obligations to set rates of gas and electric companies. n29 In addition to these specific ratemaking sections, G.L. c. 164, @ 76 grants the Department broad supervision of all gas and electric companies. n30 These statutory provisions grant the Department wide latitude in the design and setting of rates. n31 ii. Case Law

Although no Massachusetts case has directly addressed whether the Department has the authority to order the functional unbundling of rates, the courts have consistently stated that the Department's authority to design and set rates pursuant to G.L. c. 164, @ 94 is broad and substantial. Boston Real Estate Board vs. Department of Public Utilities, 334 Mass. 447 (1956) held that the Department had the authority under G.L. c. 164, @ 94 to eliminate a practice whereby an electric company sold electricity at wholesale for resale to the occupants of a building or group of buildings. The plaintiffs argued that Section 94 gives the Department jurisdiction only over "rates, prices, and charges," but that an order regulating the practice of resale is beyond the Department's power. The Supreme Judicial Court disagreed: Neither @ 94 nor the order is, in our view, to be so narrowly construed. Rate practices as well as rate scales may be regulated under a power to prescribe rates. Florida Power & Light Co. v. State, 107 Fla. 317, 321-322. The amendment to @ 94 in 1927 (St. 1927, c. 316, @ 2) significantly broadened the power of the [D]epartment. The [D]epartment recommended the amendment to cause @ 94 to read substantially as now, in order to give the [D]epartment 'jurisdiction of the entire rate structure [emphasis added].' (1927 House Doc. No. 1020, page 8.) Section 94 requires the filing of 'schedules . . . showing all rates, prices and charges . . . with all forms of contracts thereafter to be used in connection therewith.' It gives the [D]epartment jurisdiction not only over the stated rates, prices and charges for various classifications of service, and the relationship between classifications, but also over reasonably related terms and conditions stated in the service contract or the filed schedules. See Ambassador Inc. v. United States, 325 U.S. 317, 322 n. 3 (1945); Campo Corp. v. Feinberg, 279 App. Div. (N. Y.) 302 (1952), affirmed, 303 N. Y. 995 (1952), (New York Public Service Comm., Case No. 14279) (1951).

American Hoechest Corporation v. Department of Public Utilities, 379 Mass. 408 (1980), citing Massachusetts Electric Company v. Department of Public Utilities, 376 Mass. 294, 302 (1978), states a basic principle of ratemaking. "The [D]epartment is free to select or reject a particular method as long as its choice does not have a confiscatory effect or is not otherwise illegal." Boston Edison v. Department of Public Utilities, 375 Mass. 1, cert. denied, 439 U.S. 921 (1978) defined confiscatory effect: Confiscation occurs when the Department's ratemaking decision deprives a utility of the opportunity to realize a fair and reasonable return on its investment. Boston Gas Co. v. Department of Public Utilities, 368 Mass. 780, 789-790 (1975). A return is fair

and reasonable if it covers utility operating expenses, debt service, and dividends, if it compensates investors for the risks of investment, and if it is sufficient to attract capital and assure confidence in the enterprise's financial integrity.

Therefore, the case law grants the Department broad discretion in the design and setting of rates, as long as the method chosen by the Department does not have a confiscatory effect upon the utility. The Supreme Judicial Court's recognition of the Department's latitude in ratemaking supports the Department's view that it has ample authority to order the functional unbundling of rates.
iii. Department Precedent

Under G.L. c. 164, which governs both the electric and the gas industries, the Department has ruled on numerous cases of unbundling of rates in the gas industry. As a result of changes in the gas industry occasioned by FERC Order 436, in response to a petition to require the jurisdictional natural gas local distribution companies to file tariffs that provide for rates, charges and service for transportation of natural gas for industrial end-users, the Department established its general principles regarding transportation rates; these principles later resulted in unbundled transportation rates. See New England Energy Group, D.P.U. 85-178 (1987).

Numerous company-specific adjudications followed, and the Department set firm transportation rates for jurisdictional gas utilities. See, e.g., North Attleboro Gas Company, D.P.U. 94-130-A (1994); Boston Gas Company, D.P.U. 93-60 (1993); Colonial Gas Company, D.P.U. 93-78 (1993); Essex County Gas Company, D.P.U. 93-107 (1993); and Bay State Gas Company, D.P.U. 89-81 (1989).

. Seek near-term rate relief.

Electric industry restructuring should create competitive markets that are expected over time to produce prices lower for all customers than would have been paid under the current system. In addition, in the near term, utilities should work to produce rates for all customers meaningfully lower than they would have been under the current system of rate regulation. Utilities should also make available a reasonable opportunity for greater near-term rate relief for customers that choose to assume greater market risk.

. Maintain DSM programs.

The Department notes that, for many years, consumers in Massachusetts have benefitted from the energy savings and environmental benefits achieved through the demand-side management ("DSM") programs implemented by electric companies. As a direct result of utility-implemented DSM programs, a valuable infrastructure of expertise, capital and labor has developed in Massachusetts. There must be provision during the transition period to continue these benefits and to ensure that DSM has a meaningful opportunity to compete in a restructured industry. The Department believes that DSM may well be competitive in the future provided that this infrastructure is sustained during the transition. Accordingly, electric companies should continue to implement DSM programs and be provided a fair opportunity to recover prudently incurred DSM-related costs. Such recovery should continue until DSM technologies and implementation practices can compete effectively in open electricity markets but not beyond the end of the transition period.

In a restructured electric industry, competitors in the market can use DSM as a competitive strategy (i.e., either as a resource option or service offering) to attract and retain customers. Similarly, once they are provided with accurate price signals, customers should be able to evaluate and choose among an array of electricity products and services, including DSM, so that they may maximize their individual benefits.

. Ensure that the transition is orderly and expeditious, and minimizes customer confusion.

As the industry moves to what will likely be a fundamentally different structure with a more complex set of service providers, there is a potential for unintended effects adverse to the public interest. A disorderly transition process could result in customer confusion or dissatisfaction which, in turn, could undermine restructuring efforts and reduce the anticipated benefits of an improved industry structure. To ensure that the transition process is orderly and expeditious, and minimizes customer confusion, some level of regulatory oversight will be necessary.

A smooth transition process would best be achieved through a negotiation process that includes all affected parties including representatives of residential, commercial and industrial customers, utilities, independent power producers, power marketers, public interest and environmental organizations, and government agencies. As transition plans are approved for implementation, customers must be informed about when and how those plans will affect their electric service. Importantly, customers must also be made aware of any opportunities they will have to procure electric services from alternative suppliers, and of the responsibilities and risks associated with the range of choices they might be offered. V. IMPLEMENTATION

[38] In the preceding sections of this Order, the Department has stated its overall goal for a restructured industry. The Department has also identified the essential characteristics of a restructured industry, as well as the important issues to be considered in the transition to a restructured industry. To guide the process of transition, we have provided principles for the restructuring and for the interim steps toward our goal. Given the complexity of the legal, policy and technical issues in this transition, consensus and settlements are more likely than litigation to advance restructuring. Negotiation consistent with the principles established in this Order will allow stakeholders to strike an appropriate balance among competing interests and to achieve an orderly transition. The Department supports the multiple requests from commenters for a period during which participants would negotiate settlements.

In restructuring, the concepts of competition and customer choice are fundamental, and the basic principles will apply to all restructuring proposals; however, electric company corporate structures, service territories, rate structures and stranded costs may require individual treatments. Each electric company should undertake negotiations with all interested participants to develop a plan for moving toward competition in generation and retail customer choice, decide the amount and develop a mechanism for stranded cost recovery, and establish unbundled rates.

One of the basic principles behind restructuring is that it should provide all customers with an opportunity to share in the benefits of increased competition. Accordingly, any negotiations should include representatives of

residential, commercial and industrial electricity consumers in the Commonwealth. We also look forward to broad participation by such groups in subsequent proceedings before the Department as negotiated settlements are submitted for approval.

The Department is eager to move forward on restructuring through negotiations; however, it is important that movement toward a new industry structure proceed without undue delay. Therefore, the Department is unwilling to allow negotiations to continue indefinitely. Accordingly, the Department establishes a schedule by which electric companies must file the following: (1) a plan (that includes any negotiated resolutions) for moving from the current regulated industry structure to a competitive generation market and to increased customer choice; (2) illustrative rates and supporting information that, at a minimum, indicate unbundled charges for generation, distribution, transmission, and ancillary services; n32 (3) an identifiable charge reflective of the level of stranded costs to be recovered, with all necessary supporting information; and (4) a plan for incentive regulation of the transmission and distribution systems.

To avoid imposing an undue burden on the Department and on the stakeholders who may participate in several electric company restructuring negotiations, filing deadlines for settlements or, in the absence of negotiated settlements on all points, proposals to fulfill the requirements listed above, will be staggered according to the following schedule: Boston Edison Company ("BECo"), Massachusetts Electric Company ("MECo"), and Western Massachusetts Electric Company ("WMECo") will be required to submit their proposals within six months of the issuance of this Order; Cambridge Electric Light Company, Commonwealth Electric Company, Eastern Edison Company, Fitchburg Gas & Electric Company, and Nantucket Electric Company will be required to submit proposals within three months of the issuance of the Department's Orders related to the restructuring proposals of BECo, MECo, and WMECo. The Department intends to review the filings and issue an Order on each as soon as possible.

We look forward to working with the participants in the wholesale and retail electricity markets, and with the Legislature, to construct a regulatory framework that will facilitate a swift and effective transition to a restructured electric industry. VI. ORDER

Accordingly, after due notice, hearing, and consideration, it is

ORDERED: That future restructuring proposals shall be reviewed in a manner consistent with this Order. APPENDIX A: LIST OF COMMENTERS Investor-Owned Utilities

(1) Boston Edison Company

(2) Cambridge Electric Light Company, Canal Electric Company, and Commonwealth Electric Company (together, "COM/Energy")

(3) Eastern Edison Company

(4) Fitchburg Gas and Electric Light Company

(5) Massachusetts Electric Company

(6) Western Massachusetts Electric Company Municipal Light Departments and MMWEC

(7) Chicopee & Westfield Municipal Light Departments

(8) Municipal Light Departments

(9) Massachusetts Municipal Wholesale Electric Company ("MMWEC")

(10) Shrewsbury Municipal Light Department

(11) Sterling Municipal Light Department Public Officials and Government Agencies

(12) Scott Harshbarger, Attorney General

(13) Barnstable County Commissioners

(14) Massachusetts Department of Environmental Protection

(15) Massachusetts Division of Energy Resources

(16) United States Department of Energy

(17) United States Environmental Protection Agency

(18) Representative Christopher Hodgkins

(19) Senator Mark Montigny

(20) Massachusetts Water Resources Authority Other Commenters

(21) Alternative Power Source

(22) American Wind Energy Association

(23) Applied Resources Group, Inc., an independent energy consulting company

(24) Associated Industries of Massachusetts

(25) Business for Social Responsibility Education Fund

(26) Center for Energy Efficiency and Renewable Technologies

(27) Cape & Islands Self Reliance Corporation, a consumer interest group

(28) Coalition of Non-Utility Generators

(29) Connecticut River Watershed Council, Inc.

(30) Conservation Law Foundation, an advocate for DSM and renewable energy resources

(31) The Energy Consortium, an unincorporated group of industrial, commercial and institutional users of energy

(32) ENRON Capital & Trade Resources, an IPP and power marketer

(33) Institute for Energy and Environmental Research

(34) Intercontinental Energy Corporation, owner and operator of a cogeneration plant in Massachusetts

(35) International Fuel Cells, manufacturer of fuel cells and division of United Technologies Corporation

(36) International Paper Company

(37) IRATE, Inc., citizens' group formed to foster an understanding of and participation in utility rate-setting procedures

(38) Levy Associates, an independent management consulting firm

(39) Massachusetts Alliance of Utility Unions

(40) Massachusetts Energy Efficiency Council, a DSM trade association

(41) Massachusetts Public Interest Research Group

(42) National Consumer Law Center, Inc., an advocate for low-income electricity consumers

(43) National Independent Energy Producers, a national IPP trade association

(44) National Power PLC and American National Power, Inc., owner of electric-generating facilities in England and Wales, and the IPP subsidiary operating in the United States, respectively

(45) New England Cogeneration Association

(46) Pace University Law School, Office of Renewable Energy Technology Analysis

(47) Pequod Associates, an energy consulting firm

(48) Renewable News Network, advocate of renewable energy sources

(49) Retailers Association of Massachusetts

(50) Save Our Regional Economy, advocate of manufacturing jobs in Southeastern Massachusetts

(51) Trigen-Boston Energy Corporation, owner of Boston's district heating and cooling system

(52) Union of Concerned Scientists, an organization dedicated to advancing responsible public policies in areas where technology plays a critical role

(53) Wheelabrator Environmental Systems, Inc., owner of qualifying facilities

(54) Wheeled Electric Power Company, promoter of customer choice in retail electric markets APPENDIX B: LEGAL ANALYSIS OF STRANDED COST RECOVERY I. INTRODUCTION

[39-43] This appendix briefly notes commenters' arguments regarding recovery of stranded costs and contains a preliminary analysis of claims of a legal entitlement to recovery of stranded costs. This analysis is for discussion purposes. The Department reiterates its important policy finding that a reasonable opportunity for recovery of stranded costs is in the public interest. Further, the Department notes that the honoring of existing commitments is a critical foundation for the future electric industry. II. SUMMARY OF COMMENTS ON STRANDED COST RECOVERY

Generally, arguments in favor of stranded cost recovery on legal grounds rely either on the existence of a hypothesized "regulatory compact" or on Constitutional provisions that proscribe the taking of private property without just compensation. For example, in their joint memorandum on stranded cost recovery ("Joint Legal Memorandum"), Boston Edison Company ("BECo"), Cambridge Electric Light Company and Commonwealth Electric Company (collectively, "COM/Energy"), and Western Massachusetts Electric Company ("WMECo") have argued that (1) the existence of a "regulatory compact" between the Commonwealth (acting through the Department on behalf of Massachusetts ratepayers) and the utilities requires the Department to allow electric utilities to recover all stranded costs; (2) electric utilities are legally entitled to be afforded a reasonable opportunity to recover stranded costs to avoid confiscatory effects; and (3) federal and state coordination issues require the recovery of stranded costs. We address the first two contentions in Section III of this appendix; see Order, Section IV.B.1.d. for a discussion of federal-state coordination.

According to BECo, COM/Energy, and WMECo, the regulatory compact establishes that utilities have an obligation to serve all cus- tomers seeking electric service, reliably, at least cost, and at non-discriminatory rates in exchange for the right to serve within a defined service territory (Joint Legal Memorandum at 7). As part of this regulatory compact, electric utilities are subject to extensive scrutiny by government agencies and their rates are limited to recovery of only those costs that are prudently incurred, with a reasonable return on invested capital (id.). Their right to serve customers within a defined service territory is deemed by these commenters to be an exclusive franchise. Despite their claim to an exclusive franchise, however, they state that they only seek "a reasonable opportunity to recover their previously approved level of costs, and seek no greater opportunity than they would have if there were no restructuring undertaken by the Department" (id. at 28-29).

Commenters have also made policy arguments in support of stranded cost recovery. For example, Massachusetts Electric Company ("MECo") argues that regulators have an obligation, while considering prospective changes in the regulation of utilities under their jurisdiction, to fulfill the obligations created by past regulatory practices, standards, and decisions (MECo Initial Comments, Comments of Paul F. Levy at 2). WMECo contends that embedded costs are costs that should be paid by all end-users of the electric system, as well as by those customers who may be able to take advantage of opportunities outside the traditional electric system (WMECo Response to NOI Questions at 29). In the view of Fitchburg Gas and Electric Light Company ("Fitchburg"), stranded costs should be recoverable from those classes of customers that will benefit from the

transition to a more competitive market and on whose behalf the utility undertook prudent commitments pursuant to its statutory obligation m serve (Fitchburg Initial Comments at 8).

The Attorney General makes three points regarding stranded costs. First, he asserts that utilities are not entitled to insurance against the risk that market conditions may not permit full recovery of past investments (Attorney General Initial Comments at 47). Second, he urges the Department to indicate in unambiguous terms

that there is no broad absolute right to an assurance that past costs will be recovered (Attorney General Reply Comments at 4). Finally, while the Attorney General believes that the Department has sufficient authority to provide the opportunity for the recovery of such costs in the appropriate circumstances, he asks the Department to announce that such authority cannot be exercised in the abstract, but rather must await individual adjudications of the facts and law attending each particular claim of stranded costs (id.). III. ANALYSIS OF LEGAL ARGUMENTS ON STRANDED COST RECOVERY

There are two parts to the legal analysis of stranded cost recovery: (1) an analysis of whether Massachusetts electric utilities have been granted exclusive franchise rights and the implications of franchise rights for recovery of stranded costs; and (2) an analysis of whether and when Constitutional provisions against takings could be implicated by regulatory changes being considered by the Department.

A. Exclusive Franchise Rights and the "Regulatory Compact"

One way in which incumbent utilities could support their claim for stranded cost recovery is to demonstrate, rather than merely assert, that they hold exclusive franchise rights to provide customers within their service territories with generation, transmission, and distribution services. In order to support a claim to an exclusive franchise, utilities could show either that they have been explicitly granted such rights, or that a "regulatory compact" or contract somehow creates implied rights. Under an exclusive franchise, the status of an incumbent utility could be analogized to that of a party to a contract. Thus, if there were an exclusive franchise, "breach" of that exclusive franchise by the authorization of retail competition or other forms of customer choice could be compensable, depending in part on whether the value of the exclusive franchise had been impaired. A finding that utilities do possess exclusive franchise rights would not end the analysis, however, because questions would remain regarding the terms of the franchise and whether, once granted, it remained subject to change by the Department or by the Legislature, and on what terms change might occur. Likewise, a finding that a particular franchise is non-exclusive would not foreclose the possibility of compensation for impairment of that non-exclusive franchise on some other basis.

The record in this docket on the franchise question is not ample and appears largely based on a claim of an implicit grant of exclusivity. To judge whether a Massachusetts electric utility has been explicitly granted an exclusive franchise, the Department would examine corporate charters, incorporation papers, statutes, or special legislative acts, or other evidence of a state grant that explicitly awards the claimed franchise rights, whether exclusive or non-exclusive. This analysis is consistent with that employed by the Department in Ecological Fibers, D.P.U. 85-71, at 4 (1985), where the Department concluded

that the record in the case was "devoid of any evidence, aside from unsubstantiated assertions, demonstrating that [Fitchburg] has an exclusive right to provide utility service in Lunenburg." n33 See also New Bedford Gas and Edison Light Company, D.P.U. 12765 and 12799 (1959) (utility contended that it was permitted by its charter to operate anywhere within the Commonwealth). No commenter has put on record in this docket original legislative grants of franchise, acts of incorporation, or other documents in support of such a claim.

Regarding claims to implied franchise rights, the Department examines whether the comprehensive regulatory scheme in Massachusetts applied to the electric utility industry constitutes a "regulatory compact" or contract between the Commonwealth, on behalf of Massachusetts ratepayers, and the utilities. Then perhaps, so the argument runs, the regulatory compact implicitly grants exclusive franchise rights to incumbent electric utilities.

Pursuant to statute, the Department comprehensively regulates the operations of electric utility companies in Massachusetts. See Order, Section I, at 6. In exchange for compliance with this comprehensive statutory scheme and regulations promulgated by the Department under that scheme, investor-owned utilities contend that they receive an exclusive retail franchise, free from retail competition. See, e.g., Commonwealth Electric Company v. Department of Public Utilities, 397 Mass. 361, 368-369 (1986), cert. denied, 481 U.S. 1036 (1986) ("In return for its shelter from the uncertainties of the competitive marketplace, the public utility assumes the responsibility to provide adequate service at reasonable rates"); Attorney General v. Haverhill Gas Light Company, 215 Mass. 394, 399 (1913) ("'[F]ranchise' means the right to manufacture and supply gas for a particular locality and to exercise the special rights and privileges in the streets and elsewhere which are essential to the proper performance of its public duty and the gain of its private emoluments and without which it could not exist successfully"); see also Delmarva Power & Light Company v. City of Seaford, 575 A.2d 1089 (Del.Supr. 1990) (utility franchise found not explicitly exclusive, but public service commission's policy to restrict competition against pioneer utilities n34 found to warrant fair compensation from infringing municipal utility).

Sections of G.L. c. 164 that relate to the nature of franchise territories include the following: (1) G.L. c. 164, @ 21, which prohibits any regulated utility from transferring its franchise or contracting with any person to perform its duties under the franchise without legislative authority; (2) G.L. c. 164, @ 30, which authorizes the Department to permit an electric utility to conduct business in towns and cities other than those named in its charter; and (3) G.L. c. 164, @@ 87 through 91, which establish the process by which an electric utility may gain consent from a municipality to serve customers within that municipality, even though another utility may already be supplying electricity there. At first examination, G.L. c. 164, @ 21 appears to support one aspect of the regulatory compact: it prevents a utility from transferring its franchise to another person and thereby helps to enforce the obligation to serve. Rather than codifying perpetual exclusive utility franchises, the other sections cited set rules by which electric utilities may compete and be subjected to competition in both their own and other service territories. n35 They also do not help to clarify the terms of utility franchises, but instead strongly suggest that the state has retained unrestricted authority to permit competition in franchise territories at any time. Cases cited by commenters on the issues controlled by G.L. c. 164, @@ 21, 30, and 87 through 91 are consistent with the statutes, but otherwise provide no additional insight into

the regulatory compact claimed by the utilities. See, e.g., Boston Edison Company v. Boston Redevelopment Authority, 374 Mass. 37, 54-55 (1977); Boston Real Estate Board v. Department of Public Utilities, 334 Mass. 477, 486 (1956); Attorney General v. Haverhill Gas Light Company, 215 Mass. 394, 399 (1913).

To the extent that the ease in favor of stranded cost recovery rests on implied grants of exclusive franchise rights, the Department notes that no commenter has discussed or distinguished a line of cases that stands against the proposition that grants by implication may limit the exercise of the police power. See Boston Real Estate Board v. Department of Public Utilities, 334 Mass. at 488-489 ("[R]easonable and non-arbitrary action under the police power may be taken although it may diminish or destroy without compensation the value of property not actually taken"); Blair v. City of Chicago, 201 U.S. 400, 471-472 (1906) ("[A]ll rights which are asserted against the [s]tate must be clearly defined, and not raised by inference or presumption; and if the charter is silent about a power, it does not exist"); Proprietors of the Charles River Bridge v. Proprietors of the Warren Bridge, 36 U.S. 420 (1837); n36 but see Delmarva Power & Light Company v. City of Seaford, 575 A.2d 1089 (the Delmarva case may be distinguishable from others in this line because it concerns a public entity successfully competing for customers with a private franchised utility, at least implying state action). The legislative prohibition on transfer of a charter without legislative approval is consistent with these cases; a derivative doctrine is that a franchise grant from the state must be deemed as intended solely for the benefit of the corporation receiving it and hence, in the absence of express permission by the state, may not be transferred to a successor. Memphis & L.R.Co. v. Commissioners, 112 U.S. 609, 617 (1884); see also Attorney General v. Haverhill Gas Light Company, 215 Mass. at 402; Weld v. Board of Gas and Electric Light Commissioners, 197 Mass. 556, 557 (1908). The meaning and relevance of this line of cases to electric industry restructuring require explanation by proponents of any future settlements that address stranded cost recovery.

Based on this analysis, Massachusetts electric utilities' claim to exclusive franchises is, at best, uncertain. If in fact electric utilities in Massachusetts do not have exclusive franchises, it is not clear whether they would be legally due compensation for any part of a non-exclusive franchise in the event of electric industry restructuring. The Department does not state or suggest that proof of such a legal claim is categorically impossible, only that the proof has not yet been persuasively advanced and that it would be subject to legal dispute in any event.

B. Constitutional Provisions Against Regulatory Takings

Without a claim to express or implied exclusive franchise rights, utilities *may in the near future be exposed to competition that could create significant* stranded costs and possibly lead to financial distress. At issue is whether the introduction of retail customer choice in the generation market without compensation for any reduction in value of utility assets would constitute a "taking" of utility property in violation of the Fifth and Fourteenth Amendments. See Federal Power Commission v. Hope Natural Gas, 320 U.S. 591 (1944); Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679 (1923); but see Market Street Railway Company v. Railroad Commission of California, 324 U.S. 548 (1945) (the due process clause does not insure values or require restoration of values that have been lost by the operation of economic forces); Donham v. Public Service Commissioners, 232 Mass.

309 (1919).

Both the United States Constitution and the Massachusetts Constitution protect property rights of regulated electric utilities. Rates for regulated electric utilities must be designed to raise revenue that is sufficient to recover their costs, raise capital necessary to the discharge of their public duties, and otherwise assure confidence in the financial integrity of the enterprise. Duquesne Light Company v. Barasch, 488 U.S. 299, 307 (1989); Hope, 320 U.S. at 603; Bluefield, 262 U.S. at 692-693. The Supreme Court elaborated on this standard in Duquesne: [W]hether a particular rate is "unjust" or "unreasonable" will depend to some extent on what is a fair rate of return given the risks under a particular ratesetting system, and on the amount of capital upon which the investors are entitled to a return. Duquesne, 488 U.S. at 310. Under G.L. c. 164, @ 94, the Department is responsible for ensuring the "propriety" of proposed electric utility rates. In practice, the Department has interpreted this to mean that rates must be "just and reasonable." See Incentive Regulation, D.P.U. 94-158, at 42; see also Duquesne, 488 U.S. at 310. Section 94 also requires that rates set by the Department not be unjustly discriminatory or unduly preferential. See Attorney General v. Department of Public Utilities, 390 Mass. 208, 234 (1983), citing American Hoechest Corp. v. Department of Public Utilities, 379 Mass. 408, 411 (1980). Consistent with these Constitutional and statutory restrictions, the Department has found that it is within its ratemaking authority to modify, refine, or supplement the existing cost-of-service, rate-of-return ("COS/ROR") regulatory framework, or to adopt new ratemaking approaches. Incentive Regulation, D.P.U. 94-158, at 46. The Supreme Court has identified one other Constitutional concern that is pertinent here: A State's decision to arbitrarily switch back and forth between methodologies in a way which requires investors to bear the risk of bad investments at some times while denying them the benefit of good investment at others would raise serious constitutional questions. Duquesne, 488 U.S. at 315. See also Associated Gas Distributors v. FERC, 824 F.2d 981, 1021-1030 (D.C. Cir. 1987) (D.C. Circuit remanded FERC's natural gas open access decision for failure to deal with pipelines' take-or-pay exposure). At the Department, the development and implementation of pro-competitive policies have been gradual, measured, and consistent, in order to avoid the risks of arbitrary switching warned about in Duquesne.

The Constitutional principles to be applied where comprehensive regulation of an industry or service is to continue under a changed regulatory framework (e.g., a switch from COS/ROR regulation to incentive regulation) are clear. However, the principles to be applied where a rapid transition from a regulated monopoly industry to a fully competitive industry or service is being considered are not clear. In this proceeding, the Department has investigated the possibility of substantially expanding competition and introducing broad customer choice in the generation sector of the electric industry. In fact, a fully competitive generation market has been a goal of the Department for some time. See Investigation into Ratemaking Treatment for New Generation Facilities, D.P.U. 86-36-A (1989). The electric utilities argue that an "abrupt change" n37 from a regulated monopoly industry to a fully competitive industry without compensation for resultant stranded costs would be a risk unanticipated by shareholders. They contend that utilities are entitled to "reasoned consistency" in the treatment of how costs are included in rate base.

For the Department, there are two questions that arise from a consideration of the Constitutional principles to be applied during a transition from

regulation to competition: first, would the introduction of broad customer choice represent a change in the method of regulation of Massachusetts electric utilities or a form of deregulation; and second, would stranded costs that result from either a change in the method of regulation or a move toward deregulation give rise to a valid "taking" claim. The Supreme Court has identified limitations on the use of the Due Process Clause to support a "taking" claim: [T]he [D]ue [P]rocess [C]lause never has been held by this Court to require a commission to fix rates on the present reproduction value of something no one would presently want to reproduce, or on the historical valuation of a property whose history and current financial statements showed the value no longer to exist, or on an investment after it has vanished, even if once prudently made, or to maintain the credit of a concern whose securities already are impaired. The [D]ue [P]rocess [C]lause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces. Market Street, 324 U.S. at 567. See also Commonwealth Electric Company, 397 Mass. at 368 ("The ratepayers are not the guarantors of the company's success"); Donham., 232 Mass. at 317. n38

The reasoning applied by FERC to the stranded cost issue in its Open Access NOPR sheds light on possible distinctions between changes in regulatory methods and deregulation. FERC's Open Access NOPR would impose significant new requirements on public utilities that would help FERC to achieve the goal of robust competitive wholesale markets (Open Access NOPR at 138-139). FERC's proposal in the Open Access NOPR would give a utility's historical wholesale customers enhanced opportunities to reach new suppliers and, therefore, would affect the way in which utilities traditionally have recovered costs (id. at 139). FERC's view is that utilities should be allowed to recover the costs incurred under the old regulatory regime according to the expectations of cost recovery established under that regime (id. at 139-140). FERC, however, is not proposing to deregulate transmission service under its jurisdiction. Rather, to ensure that all participants in wholesale electricity markets have non-discriminatory open access to the transmission network, FERC seeks to require all transmission owners to "offer non-discriminatory open access transmission and ancillary services to wholesale sellers and purchasers of electric energy in interstate commerce" (id. at 88-89).

Given that FERC is pursuing a major change in its regulation of transmission, the electric utilities under its jurisdiction may have a strong legal entitlement to recovery of costs that could be stranded as a result of this shift and it may therefore be appropriate for FERC preemptively to propose its own stranded cost recovery mechanism. FERC's investigation, however, seems clearly distinguishable from the Department's, which concerns the feasibility of expanding competition and customer choice in the generation sector of the Massachusetts electric utility industry. While the pricing of transmission services would remain subject to review under FERC's proposal, the Department anticipates that the pricing of generation in a competitive generation market would be determined by market forces, not by an administrative process.

The Department concludes, as with exclusive franchises, that it is uncertain whether Massachusetts electric utilities have any legal entitlement to stranded cost recovery based on arguments of confiscation arising from a Department decision to expand competition in the electric generation market and to introduce customer choice. It appears that the utilities are in the strongest position to argue that they would have a legal entitlement to stranded cost

recovery during a regulatory transition from regulated to fully competitive electric generation. However, this issue could be rendered moot once generation competition and customer choice have commenced, if jurisdictional utilities are not hindered by Department regulation from competing against newcomers. n39

FOOTNOTES

n1 During the 1970s and through the early 1980s, numerous regulatory reforms lessened the degree to which a number of industries were subject to economic regulation by government. These industries include the airlines, railroads, trucking, telecommunications, cable television, brokerage services, and natural gas. The quantitative benefit from these changes has been substantial. According to one estimate, society has gained at least $ 36-$ 46 billion (in 1990 dollars) annually from deregulation, primarily in the transportation industries. This gain equates to an improvement of 7 to 9 percent in the component of Gross National Product affected by regulatory reform. The bulk of these benefits has been captured by consumers. See "Economic Deregulation: Days of Reckoning for Microeconomists," Clifford Winston (The Brookings Institution), Journal of Economic Literature at 1264, 1284-1285 (September 1993). The Department has been encouraged by the results achieved in industries that have made the transition from regulation to competition and this has led us to examine whether similar improvements can be achieved in the electric utility industry.

n2 Maintaining industrial competitiveness and affordability to consumers appears to be a prime motivating factor behind the decisions in other jurisdictions to investigate the transition to a more competitive environment in the electric industry. Proposed Policy Decision Adopting a Preferred Industry Structure, CA.P.U.C. Case R.94-04-031/I.94-04-032, at 4 (Issued May 24, 1995).

n3 The Department regulates eight investor-owned electric companies: Boston Edison Company; Cambridge Electric Light Company; Commonwealth Electric Company; Eastern Edison Company; Fitchburg Gas and Electric Light Company; Massachusetts Electric Company; Nantucket Electric Company; and Western Massachusetts Electric Company. These companies, either directly or through affiliates, own electric generation facilities, high-voltage transmission networks, and low-voltage distribution networks that are used to serve customers in their service territories. Because they control the process from the generation of electricity to its final distribution to consumers, they are known as vertically integrated utilities.

n4 The four are Eastern Edison Company, a subsidiary of Eastern Utilities Associates; Fitchburg Gas and Electric, a subsidiary of UNITIL Corporation; Massachusetts Electric Company, a subsidiary of New England Electric System; and Western Massachusetts Electric Company, a subsidiary of Northeast Utilities.

n5 Before 1919, the electric and gas utility industries were regulated by the Department's predecessor agencies, the Board of Gas and Electric Light Commissioners and the earlier Board of Gas Commissioners.

n6 See, e.g., Report of the Special Commission on Control and Conduct of Public Utilities, Authorized by Resolves of 1929, Chapter 55 (House No. 1200), at 48-49 (1930). The Department notes that not all functions performed by vertically integrated electric utilities exhibit the characteristics of natural monopoly; for example, it appears that generation services can be provided on a competitive basis.

n7 The observed gap also reflects, in part, the difference between retail rates based on long-run historical costs and short-run wholesale prices that are low due to excess capacity. There are strong indications, however, that there is a long-term gap that is not dependent on the current excess electric generating capacity that exists in Massachusetts and New England. Because of technological advances and the reduction of construction times, the long-run incremental cost of new generation is likely to be below the cost of existing generation; this situation could persist for some time into the future. This is in some ways reminiscent of the situation that existed between 1950 and the 1973 oil price shock, during which time the average cost of electricity fell as more efficient generating units entered service. A Report to the California Public Utilities Commission by the Division of Strategic Planning, California Public Utilities Commission, at 24 (February 1993).

n8 The six ancillary services enumerated by FERC include (1) reactive power/voltage control, (2) loss compensation, (3) scheduling and dispatch, (4) load following, (5) system protection service, and (6) energy imbalance service. Open Access NOPR at 110-115.

n9 FERC's preliminary view is that the functional separation of wholesale services and commensurate unbundling of rates is necessary to implement non-discriminatory open access. The Open Access NOPR would require that a public utility's uses of its transmission system for the purpose of engaging in wholesale sales and purchases of electric energy be functionally separated from other activities, and that transmission services (including ancillary services) be taken under its filed transmission tariff of general applicability. The Open Access NOPR would not require "corporate unbundling" (the divestiture of assets, or the establishment of a separate corporate affiliate to manage a utility's transmission assets), but would accommodate it. Open Access NOPR at 94.

n10 In its Investigation into Ratemaking Treatment for New Generation Facilities, D.P.U. 86-36-A (1989), the Department stated that "[w]here competition begins to emerge in business segments previously exhibiting natural monopoly characteristics, it may be appropriate or even essential that regulatory constraints be removed in favor of competitive market forces." Id. at 12; see also IRM Rulemaking, D.P.U. 89-239 (1990); Qualifying Facility Regulations, D.P.U. 84-276-B (1986).

n11 The Department strongly encouraged all jurisdictional gas and electric utilities to devise and propose incentive plans and expects that incentive plans will be filed either as unilateral petitions or as joint settlements. Incentive Regulation, D.P.U. 94-158, at 65.

n12 The Department held these hearings on April 12, 13, 18, 19, 24, 25, 26, 27, and 28 and May 8, 9, and 10, 1995.

n13 The signatories to the interdependent principles filed by the Massachusetts Electric Industry Restructuring Roundtable include: Action, Inc. a Community Action Program; American National Power, Inc.; Associated Industries of Massachusetts; Attorney General; Boston Edison Company; Cambridge Electric Light Company; Coalition of Non-Utility Generators, Inc.; Commonwealth Electric Company; Conservation Law Foundation; Eastern Edison Company; Massachusetts Department of Environmental Protection; Massachusetts Division of Energy Resources; Massachusetts Electric Company; Massachusetts Energy Directors Association; Massachusetts Energy Efficiency Council, Inc.; New England

Cogeneration Association; The Energy Consortium; Smaller Business Association; and Massachusetts Audubon Society.

n14 The Department recognizes that under real-world conditions perfect competition cannot be achieved, since markets suffer such unavoidable constraints as imperfect information. Nevertheless, in striving for a fully competitive market, the Department seeks to ensure that certain impediments to competition, such as barriers to entry and use of monopoly power, are removed to the extent possible.

n15 The Department makes a distinction here between retail service reliability and bulk power system reliability. While it is essential that the bulk power system (including transmission and distribution) operate in a reliable manner, individual customers should have the option to choose various levels of reliability in their electric service.

n16 Horizontal market power in the electric industry could arise from undue concentration in the ownership of facilities at the same level in the chain of production. Such concentration could enable one or a few market participants to influence prices to their own benefit.

n17 Vertical market power in the electric industry could arise from one or a few market participants each having joint ownership of transmission, distribution, and generation facilities, and using such joint ownership to influence price in the market.

n18 Vertical integration is defined as the ownership or control of successive stages of the production process, as between generation and transmission or distribution.

n19 The Massachusetts Antitrust Act, G.L. c. 93, @ 1, states that "the purpose of this chapter [is] to encourage free and open competition in the interests of the general welfare and economy by prohibiting unreasonable restraints of trade and monopolistic practices in the commonwealth. This act shall be construed in harmony with judicial interpretations of comparable federal antitrust statutes insofar as possible."

n20 There are indications that immunities afforded by the state action doctrine, Parker v. Brown, 317 U.S. 341 (1943), are under increasing judicial scrutiny. See California Retail Liquor Dealers Assn. v. Midcal Aluminum, 445 U.S. 97 (1980); Patrick v. Burget, 486 U.S. 94 (1988); American Telephone & Telegraph Co., et al., Civ. Action Nos. 90-12866-NG and 92-10919-NG, Slip Op. at 12, 22 (D. Mass. 1995), citing Federal Trade Commission v. Ticor Title Insurance Company, et al., 504 U.S. 621 (1992).

n21 The Sherman Act, Section 1, prohibits contracts, combinations, or conspiracies - forms of concerted behavior - which restrain trade unreasonably, including price fixing, market division, group boycotts (also known as concerted refusals to deal) and tying arrangements, which are per se illegal, as well as other unreasonable restraints of trade. 15 U.S.C. @ 1; G.L. c. 93, @ 4. The Sherman Act, Section 2, prohibits monopolization and attempts to monopolize, through such means as predatory pricing, refusals to deal (including application of the "Essential Facilities Doctrine," United States v. Terminal Railroad Association, 224 U.S. 383 [1912]; Otter Tail Power Co v. United States, 410 U.S. 366 [1973]), monopoly leveraging, and cross-subsidization, among others. 15

U.S.C. @ 2; G.L. c. 93, @ 5. Additionally, anticompetitive mergers, acquisitions, and certain joint ventures may be prohibited under the Clayton Act, Section 7, and a related state statute applicable to electric utilities. 15 U.S.C. @ 18; G.L. c. 164, @ 96.

n22 The Department notes that electric utilities may incur some costs during the transition period in order to attain stated public policy objectives. The Department will ensure that electric utilities with any such prudently-incurred costs will have a reasonable opportunity to recover them before the transition period ends.

n23 By "incumbent," we mean the existing electric companies regulated by the Department under G.L. c. 164.

n24 In Appendix B, the Department reviews legal arguments in support of stranded cost recovery based on explicit or implied exclusive franchise rights and Constitutional provisions requiring compensation for regulatory takings. Whether franchise-based claims of entitlement to stranded costs are legally well-grounded requires additional inquiry.

n25 The decisions of the Supreme Court in Federal Power Commission v. Hope Natural Gas, 320 U.S. 591 (1944), and Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679 (1923), require no more than a "reasonable opportunity" for regulated utilities to recover their investments. Some stranded cost recovery proposals, such as the access charge proposed by WMECo and others, could, if not carefully designed, convert the opportunity to recover stranded costs into a guarantee. It is not the intention of the Department to provide a greater opportunity than is available today.

n26 The Department concludes that a stranded cost recovery mechanism implemented during a regulatory transition period would be relatively secure from legal challenge. Once full competition in the generation market is underway, however, access charges to collect stranded costs may be subject to legal challenge by market participants, including utility customers, at the Department or in the courts.

n27 The Department is studying FERC's description of its jurisdiction with regard to stranded costs and the questions that have been raised by FERC's proposed stranded cost recovery policy.

n28 Mitigation measures could include the following: (1) streamline existing operations; (2) identify supplemental revenue streams to support existing generating facilities; (3) sell excess generating facilities; and (4) accelerate depreciation and asset writedown provisions. See, e.g., Trigen-Boston Energy Corporation Initial Comments at 5.

n29 G.L. c. 164, @ 94 states in pertinent part: "Gas and electric companies shall file with the [D]epartment schedules, in such form as the [D]epartment shall from time to time prescribe, showing all rates, prices and charges to be thereafter charged or collected within the commonwealth for the sale and distribution of gas or electricity . . . . So much of said schedules shall be printed in such form and distributed and published in such manner as the [D]epartment may require."

G.L. c. 164, @ 94G (b) states in pertinent part: "The [D]epartment may

approve an itemized fuel charge in rates filed by electric companies to reflect changes in prudently incurred reasonable costs of fuels and power purchased by such companies . . . . The burden of proof shall be upon the utility company to demonstrate the reasonableness of energy expenses sought to be recovered through the fuel charge . . . . No such fuel charge shall be billed to customers without the specific approval of the [D]epartment after a public hearing."

n30 G.L. c. 164, @ 76 states in pertinent part: "The [D]epartment shall have the general supervision of all gas and electric companies and shall make all necessary examination and inquiries and keep itself informed as to the condition of the respective properties owned by such corporations and the manner in which they are conducted with reference to the safety and convenience of the public, and as to their compliance with the provisions of law and the orders, directions and requirements of the [D]epartment . . . ."

n31 While the Department has the authority to approve the voluntary divestiture of assets from one electric company to another, if it finds the sale is in the public interest, see G.L. c. 164, @ 96, there is no explicit statutory authority by which the Department may order divestiture, nor is it likely to be implied.

n32 Based on rate impact and other policy considerations, the Department will require utilities to (1) file tariffs consistent with those illustrative unbundled rates, (2) delineate those unbundled service costs for informational purposes on customer bills without implementing an immediate change to the rates by which bills are calculated, or (3) pursue some other approach.

n33 Whether a franchise or service territory is exclusive or, if exclusive, encompasses more than transmission and distribution may be debated. See, e.g., Attorney General v. Walworth Light & Power Company, 157 Mass. 86, at 87-88 (1892) (monopoly discussed solely in terms of transmission and distribution). Franchising by the Commonwealth is an ancient feature of Massachusetts law, but case law, while suggestive, does not appear dispositive. Cases illustrating the development, nature, and obligations of Massachusetts franchises include Spring v. Lowell, 1 Mass. 422, 430 (1805); Wales v. Stetson, 2 Mass. 142, 146 (1806); Stoughton v. Baker, 4 Mass. 521, 526-531 (1808); Proprietors of Charles River Bridge v. Proprietors of Warren Bridge, 6 Pick. [23 Mass.] 376, 403-408 (1828); Proprietors of Charles River Bridge v. Proprietors of Warren Bridge, 7 Pick. [24 Mass.] 344, 442-532 (1829) ("The general rule is, that in government grants nothing passes by implication," Morton, J., at 461); Lumbard v. Stearns, 4 Cush. [58 Mass.] 60, 62 (1849); Braslin v. Somerville Horse Railroad Company, 145 Mass. 64, 67-68 (1887); Proprietors of Mount Hope Cemetery v. City of Boston, 158 Mass. 509, 521-522 (1893); Turner v. Revere Water Company, 171 Mass. 329, 334-335 (1898); Boston Real Estate Board v. Department of Public Utilities, 334 Mass. 477, 488-492 (1956). G.L. c. 164, @@ 87-88, suggest that franchises are not exclusive. Certainly, the history of the franchise in Massachusetts is complex.

For records of incorporations, mergers, and acquisitions, see Manufactured Gas Waste Generic Investigation, D.P.U. 89-161 (1990), Exhibit DPU-15-A (Flow-chart Depicting Corporate History of Gas and Electric Utilities in Commonwealth of Massachusetts).

n34 A "pioneer utility" is the first to serve an area. The Department has no

similar policy favoring pioneer utilities over potential competitors.

n35 WMECo in its reply comments concedes that the Legislature has retained the right to amend utility charters and franchises (WMECo Reply Comments at 31). However, WMECo also contends that legislative action regarding electric utility franchises would constitute a taking and would thereby trigger certain Constitutional protections that are discussed in more detail in Appendix B, Section III.B., below. This question is of particular importance with regard to the Department's authority to promote customer choice. WMECo, for example, argues that the Legislature, not the Department, has authority to amend a utility's franchise (WMECo Reply Comments at 32). The Attorney General, however, contends that the Department itself has the power to amend franchises in the public interest (Attorney General Initial Comments at 57, citing Holyoke Street Railway Company v. Department of Public Utilities, 347 Mass. 440, 445 (1964)). Assuming the Attorney General's contention is correct, Department authority is still delegated by the Legislature.

The Department's precedent suggests that the Department has authority to promote customer choice. In Gas Transportation Rates, D.P.U. 85-178 (1987), the Department began the process of facilitating customer choice of supplier in the natural gas industry. Also of note is the Supreme Judicial Court's recent decision in Massachusetts Oil Heat Council v. Department of Public Utilities, 418 Mass. 798 (1994), where the Court relied, in part, on "the discretion granted [to the Department] under [G.L. c. 164, @ 94] to promote the policy of increased competition in the energy market." The Department has broad authority to regulate the electric industry under G.L. c. 164, @ 94. See Incentive Regulation, D.P.U. 94-158, at 42-43 (1995); see also Boston Gas Company v. Somerville, 420 Mass. 702, at 704 (1995); Boston Real Estate Board v. Department of Public Utilities, 334 Mass. 477, at 484-485 (1956).

n36 In discussing the nexus between the police power and the Contracts Clause, U.S. Const., Art. I, @ 10, Cl. 1, this seminal case previews many of the arguments recently advanced, whether pro or con; on the question of stranded costs. See Charles River Bridge, 36 U.S. at 534-551 (majority opinion of Taney, C.J.) and 581-649 (dissenting opinion of Story, J.); see also Charles River Bridge, 7 Pick. [24 Mass.] at 442-532.

n37 See Order, Section I, at 10-11 for a discussion of the Department's ongoing efforts to encourage competition in the electric industry.

n38 Commenters have sought to distinguish Market Street and Donham from the changes being considered in the instant inquiry (see Joint Legal Memorandum at 25-28).

n39 There is interaction between federal and state regulatory authorities regarding two types of stranded costs: (1) contractual commitments entered into pursuant to PURPA; and (2) liabilities for future decommissioning and radioactive waste disposal associated with nuclear power plants. In the case of contracts made under PURPA, utilities may be required by statutory and regulatory mandates to keep these contractual commitments. If utilities cannot mitigate these commitments, the Department might be obligated to develop a stranded cost charge that would allow jurisdictional utilities a reasonable opportunity to recover these costs.

In the case of stranded costs associated with future liabilities of nuclear

power plant owners, federal law that seeks to protect public safety could also override the lack of exclusive franchises. If nuclear power plant owners were unable to collect from a competitive market revenues sufficient to cover anticipated liabilities that arise from operation of those plants over time, Congress might intervene to ensure that some adequate revenue source is provided. Whether it is appropriate for state regulators to address this issue at this time is an open question. EDITOR'S APPENDIX PUR Citations in Text [CAL.] Re Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, 161 PUR4th 217, R.94-04-031, May 24, 1995. [MASS.] Re Guidelines and Standards for Acquisitions and Mergers of Utilities, 155 PUR4th 320, D.P.U. 93-167-A, Aug. 3, 1994. [MASS.] Re Incentive Regulation for Electric and Gas Companies, 159 PUR4th 585, D.P.U. 94-158, Feb. 24, 1995. [MASS.] Re Integrated Resource Management Practices, 116 PUR4th 67, D.P.U. 89-239, Aug. 31, 1990. [MASS.] Re Intrastate Nat. Gas Transportation Service, 86 PUR4th 23, D.P.U. 85-178, Aug. 7, 1987. [MASS.] Re Investigation Into Ratemaking Treatment for Remediation of Hazardous Waste from the Manufacture of Natural Gas, 115 PUR4th 275, D.P.U. 89-161, May 25, 1990. [MASS.Sup.Jud.Ct.] Boston Gas Co. v. Massachusetts Dept. of Pub. Utilities, 368 Mass. 780, 13 PUR4th 147, 366 N.E.2d 713 (1975). [MASS.Sup.Jud.Ct.] Boston Real Estate Board v. Massachusetts Dept. of Pub. Utilities, 334 Mass. 477, 15 PUR3d 47, 136 N.E.2d 243 (1956). [MASS.Sup.Jud.Ct.] Donham v. Massachusetts Pub. Service Commission, 232 Mass. 309, P.U.R.1919C 880, 122 N.E. 397 (1919). [MASS.Sup.Jud.Ct.] Massachusetts Oil Heat Council v. Massachusetts Dept. of Pub. Utilities (abstract), 418 Mass. 798, 158 PUR4th 431, 641 N.E.2d 1318, Nov. 14, 1994. [U.S.Ct.App.(D.C.)] Associated Gas Distributors v. Federal Energy Regulatory Commission, 83 PUR4th 459, 824 F.2d 981 (1987). [U.S.Sup.Ct.] Ambassador, Inc. v. United States, 325 U.S. 31;7, 58 PUR(NS) 193, 89 L.ed.2d 1637, 65 S.Ct. 1151 (1945). [U.S.Sup.Ct.] Bluefield Water Works & Improv. Co. v. West Virginia Pub. Service Commission, 262 U.S. 679, P.U.R.1923D 11, 67 L.ed 1176, 43 S.Ct. 675 (1923). [U.S.Sup.Ct.] Duquesne Light Co. v. Barasch, 488 U.S. 299, 98 PUR4th 253, 102 L.Ed.2d 646, 109 S.Ct. 609 (1989). [U.S.Sup.Ct.] Federal Power Commission v. Hope Nat. Gas Co., 51 PUR(NS) 193, 320 U.S. 591, 88 L.ed 333, 64 S.Ct. 281 (1944). [U.S.Sup.Ct.] Market Street R. Co. v. California Railroad Commission, 324 U.S. 548, 58 PUR(NS) 18, 89 L.ed 1171, 65 S.Ct. 770 (1989). [U.S.Sup.Ct.] Otter Tail Power Co. v. United States, 410 U.S. 366, 97 PUR4th 209, 35 L.Ed.2d 359, 93 S.Ct. 1022 (1973).

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